

June 17, 2003

Mary L. Cottrell, Secretary  
Department of Telecommunications and Energy  
One South Station  
Boston, Massachusetts 02110

Re: The Berkshire Gas Company, D.T.E. 02-19

Dear Secretary Cottrell:

On April 5, 2002, The Berkshire Gas Company ("Berkshire" or the "Company") submitted a Gas Portfolio Optimization Agreement ("Optimization Agreement") dated as of March 25, 2002 and a Gas Sales and Purchase Agreement ("Purchase Agreement") dated as of March 25, 2002 each with BP Energy Company ("BP") to the Department for approval pursuant to G.L. c. 164, §§76 and 94A. In an Order dated September 30, 2002, the Department approved the Optimization Agreement and Purchase Agreement subject to the condition that Berkshire provide a report at the end of each year of the two year term of the agreements. In that Order, the Department directed the Company to "submit to the Department annual reports detailing any refinements to the allocation methodology . . . , including the savings dollars accruing to the Company . . . and a summary of the BP transactions on behalf of the Company." The annual report was to also highlight any "problems that may have arisen during implementation of the Agreement." The initial year of the term of the Optimization Agreement and the Purchase Agreement ended on March 31, 2003. Berkshire is pleased to be able to provide its first annual report addressing the requirements of the September 30, 2002 decision. As demonstrated in Attachment A, the level of savings achieved in the first year pursuant to the Optimization Agreement was greater than the savings achieved during the initial one year term of similar agreements approved in D.T.E. 01-41.

### Refinements to the Allocation Methodology

The procedures used during this first year of the term of the Optimization Agreement for allocation were updated based on recommendations that were made in the audit report provided in DTE 01-41. First, as noted during the evidentiary hearing in D.T.E. 02-19, effective April 1, 2002 the Energy East Companies local distribution companies ("LDC's"), including Berkshire, and not BP, were responsible for the actual allocation of the savings categories calculated and reported by BP each month to the LDC's. This was a change from the prior year when BP allocated the dollars to the LDC's. Second, an Allocation Team comprised of Company, LDC and BP personnel was responsible for developing and implementing procedures for (a) calculating, reviewing and approving the allocated savings dollars, (b) identifying and communicating information and documentation requirements to BP, and (c) ensuring that procedures were updated, as necessary, to reflect the requirements of the Agreements. The Allocation Team helped to maintain compliance with all procedural and substantive requirements of the Optimization Agreement. These refined procedures built upon the successful implementation of procedures from the later months of the previous one-year optimization alliance.

### Optimization Savings

Total monthly optimization savings are identified and validated by performing a detailed monthly cash flow reconciliation for each month. This reconciliation is performed by each LDC, including Berkshire. Further, the Allocation Team randomly selects two months per year, at a minimum, to validate the specific transactions in each of the categories of optimization transaction. At least one summer and one winter month are selected. Additionally, on a quarterly basis, BP makes actual optimization payments to each LDC based on participating share. Finally, at the end of the year, the LDCs finalize the allocations for the 12 months ended March 31. At that time, the LDCs will exchange funds to reconcile or "true up" based upon actual, verified allocations.

Attachment A provides the quarterly savings generated for Berkshire and the method of allocation used to establish the savings. This attachment demonstrates that the optimization dollars earned by Berkshire for the first year pursuant to the Optimization Agreement were greater than the optimization dollars earned the prior year.

The Company has made two appropriate adjustments to the level of "gross" savings from alliance transactions properly allocated to Berkshire, both of which are reflected in Attachment B. First, the Company reflected the payments properly due to BP pursuant

to Article IV of the Optimization Agreement. Specifically, the "BP Energy Savings" were determined consistent with Section 4.3 of the Portfolio Agreement. Second, the Company "netted" savings against only certain external legal costs necessary to secure the benefits of the alliance. These costs were associated with the procurement, negotiation and presentation of the alliance structure to the Department. These external costs were necessary to achieve the alliance benefits and the Company has allocated them equally to each year of the two-year term of the alliance. Importantly, consistent with the Company's representation during the Department's review, the Company has not sought the recovery of charges from affiliates associated with the alliance. Further, no procurement-related costs associated with the alliance are reflected in the Company's base rates.

Berkshire is pleased to report that the alliance resulted in significant cost savings beyond that which might be obtained from the Company's approved supply contracts. In addition, as noted by the Company in the case of D.T.E. 02-19, the alliance contributed to an overall resource planning strategy, providing more substantial benefits in volatile market conditions experienced during the initial year of the alliance term. Berkshire's customers will continue to enjoy the substantial benefits of the alliance structure while only bearing a portion of external costs associated with implementing the alliance.

#### Implementation

The Company is pleased to report that implementation of the Agreement was smooth and only limited issues occurred during the year. This outcome was the result of earlier efforts to refine procedures during the initial term of the alliance and the Company's compliance with the limited recommendations from the audit process. Concerns were handled in daily conference calls, follow-up phone calls, or during face-to-face meetings with BP. Most concerns dealt with improving communication and securing follow-up information or clarifications when appropriate in the ordinary course of validating optimization. The Company expects the positive working relationship to continue in the second year of the term of the Optimization Agreement.

Please note that Attachments A and B contain confidential information and are provided to the Department consistent with the April 5, 2002 Motion for Confidentiality in this proceeding. The materials are provided to the Attorney General and the Division of Energy Resources pursuant to confidentiality agreements.

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As always, should you have any questions, do not hesitate to contact me. Thank you for your consideration.

Sincerely,

Karen L. Zink  
Vice President and General Manager

cc: Service List  
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